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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In re

No. 20-01808

KING MOUNTAIN TOBACCO
COMPANY, INC.,

Debtor.

EMERGENCY MOTION FOR ORDER
AUTHORIZING INTERIM USE OF
CASH COLLATERAL AND GRANTING
ADEQUATE PROTECTION, AND
SETTING FINAL HEARING

King Mountain Tobacco Company, Inc. (“Debtor” or “King Mountain”), debtor-in-possession herein, moves the court on an emergency basis (“Motion”) pursuant to Bankruptcy Code¹ sections 363(c) and (e), Fed. R. Bankr. P. 4001(b)–(d), and Local Bankruptcy Rule 4001-2, for entry of an order: (1) authorizing, on an interim basis, the Debtor’s use of Cash Collateral (as defined below) pending a final hearing; (2) granting, on an interim basis, adequate protection of the security interests of the TTB (as defined below) pending a final hearing; and (3) setting a final hearing on the foregoing matters. This Motion is based upon the records and files herein, and the accompanying Declaration of Truman J. Thompson filed contemporaneously herewith.

¹ All references are to the United States Bankruptcy Code and the Federal Rules of Bankruptcy Procedure unless otherwise noted.

I. SUMMARY

Pursuant to Fed. R. Bankr. P. 4001(b)(1)(B), the Debtor sets forth the following summary of this Motion:

1. Entity with interest in cash collateral: King Mountain seeks authority to use the cash collateral of the Alcohol and Tobacco Tax and Trade Bureau (“TTB”).
2. Purposes for the use of cash collateral: The use of cash collateral will allow King Mountain to timely and fully pay its payroll and other operating expenses so as to permit it to continue its ordinary course operations and to maintain its ongoing business for the benefit of its estate and creditors. King Mountain has an immediate need to use cash collateral to maintain, preserve and protect its assets and has provided for adequate protection of the TTB’s interests in the cash collateral.
3. Material terms of the use of cash collateral: King Mountain seeks use of cash collateral during the pendency of this case in accordance with its proposed Budget.
4. Liens and Adequate Protection: Adequate protection to be provided to the TTB for use of cash collateral includes:
 - (a) replacement liens in King Mountain’s postpetition assets of the same kind, type, and nature as the prepetition collateral in which the TTB held a lien and in the same validity and enforceability as any prepetition lien in prepetition collateral;
 - (b) maintenance of insurance on King Mountain’s assets; and
 - (c) to the extent of any diminution in value of the TTB’s interest in the prepetition collateral due to cash collateral use which is not otherwise protected by the replacement liens, the TTB shall retain its rights under 11 U.S.C. § 507(b).

II. FACTUAL BACKGROUND

King Mountain commenced its chapter 11 case on September 25, 2020 (“Petition Date”). The Debtor is operating its business and managing its affairs as a debtor-in-possession under 11 U.S.C. §§ 1107 and 1108. No trustee has been appointed in this case. A detailed discussion of the Debtor’s business operations and events leading up to this chapter 11 case is set forth in the Declaration of Truman J. Thompson in Support of Debtor’s Emergency First Day Motions [ECF No. 5].

A. The Debtor and its Operations

King Mountain Tobacco Company, Inc. is a Native American owned and operated tobacco grower and product manufacturer based in White Swan, Washington, within the boundaries of the Yakama Nation Reservation. *Thompson Decl.*, ¶ 3. King Mountain was founded and incorporated in 2005 under the laws of the Yakama Nation, and registered as a foreign corporation with the State of Washington. *Id.*

In February 2007, King Mountain received its permit to manufacture cigarettes from the Alcohol and Tobacco Tax and Trade Bureau (the “TTB”). *Id.*, ¶ 4. The permit was first listed for purposes of the tobacco Master Settlement Agreement in Washington State in the fall of 2007. *Id.* King Mountain has since expanded its sales across 12 states. *Id.*

B. The TTB Federal Tax Lien

Beginning in or around 2009, King Mountain experienced cash flow difficulties resulting from breached agreements with certain distributors that were unable to deliver on promised levels of purchasing and from nonpayment by a large distributor in South Carolina, resulting in a total loss to King Mountain of nearly \$16 million in cash flow.

1 *Thompson Decl.*, ¶ 5. These cash flow issues, combined with advice of counsel and
2 King Mountain's firmly held belief regarding the protections guaranteed in the Yakama
3 Treaty, led to its very first failure to pay federal excise taxes ("FET"). *Id.*

4 In 2011, King Mountain filed a complaint against the United States for injunctive
5 and other relief, arguing that it was not subject to taxation under the General Allotment
6 Act of 1887, 4 Stat. 388, nor the Treaty with the Yakamas of 1855, 12 Stat. 951. The
7 District Court for the Eastern District of Washington ruled in favor of the federal
8 government, upheld the excise taxes imposed by the TTB, and entered a judgment
9 against King Mountain of almost \$58 million. The Ninth Circuit Court of Appeals
10 affirmed the judgment, and the United States Supreme Court denied a petition for
11 certiorari in June 2019. As of today, the amount owed on account of unpaid FET
12 exceeds \$75 million in principal, interest and penalties. *Thompson Decl.*, ¶ 6.

13 Notwithstanding these challenges, King Mountain has remained in operation and
14 remains current on all FET and escrow obligations since April of 2013. King
15 Mountain, through counsel, has been in communication with the Department of Justice
16 to work towards an agreement to settle the outstanding debt associated with unpaid
17 FET. During this process, King Mountain provided documents detailing its financial
18 position to show available cash flow for potential repayments. *Thompson Decl.*, ¶ 7.

19 On behalf of the TTB, on August 25, 2020, the Department of the Treasury sent
20 King Mountain a final notice and demand for repayment of the outstanding FET.
21 According to the government's calculation, the amount owed is \$75,467,193.24,
22 consisting of \$38,330,298.27 of principal, \$18,336,086.92 of interest, \$9,135,348.90 for
23 failure to file timely and \$9,665,459.15 for failure to pay timely. The government

1 threatened to levy against King Mountain's assets if payment was not made within
2 thirty days of King Mountain's receipt of the demand letter. *Thompson Decl.*, ¶ 8.

3 King Mountain filed its voluntary chapter 11 petition on September 25, 2020.
4 Unbeknownst to King Mountain at the time of filing, on the afternoon of September 24,
5 2020, the TTB filed a UCC Financing Statement and Notice of Federal Tax Lien
6 ("Federal Tax Lien") with the State of Washington Department of Licensing ("DOL").
7 *Thompson Decl.*, ¶ 10. The Federal Tax Lien, if properly perfected, constitutes a
8 prepetition lien in favor of the United States "upon all property and rights to property,
9 whether real or personal," belonging to the Debtor ("Prepetition Collateral"). *See* 26
10 U.S.C. § 6321.

11 King Mountain did not receive notice of the Federal Tax Lien until October 15,
12 2020, almost three weeks after this case was filed. *Thompson Decl.*, ¶ 10. Upon
13 receiving notice of the UCC filing, counsel for King Mountain immediately requested
14 an official copy of the UCC filing from the DOL. *Id.*, ¶ 11. Counsel received an
15 official copy by mail on October 26, 2020. *Id.*, ¶ 12.

16 **C. Use of Cash Collateral and Adequate Protection**

17 King Mountain requires the immediate use of cash proceeds from the collection
18 of customer contracts and accounts receivable ("Cash Collateral") to fund payroll and
19 related payroll expenses and other fundamental operating expenses, and to otherwise
20 minimize disruption to and avoid termination of its operations, and thereby avoid
21 immediate and irreparable harm to its business pending a final hearing pursuant to
22 Bankruptcy Rules 4001(b)(2) ("Final Hearing"). *Thompson Decl.*, ¶ 13. King
23 Mountain proposes to use Cash Collateral pursuant to the terms set forth herein and the

1 budget attached as Exhibit A to the Thompson Declaration (the “Budget”). The Debtor
2 would otherwise not use Cash Collateral for any purpose that is not authorized by the
3 Bankruptcy Code, the Budget, or the order approving this Motion (“Interim Order”).

4 The interests of the TTB will be adequately protected as follows:

5 1. Replacement Liens

6 Pursuant to Sections 361 and 363 of the Bankruptcy Code, King Mountain
7 proposes to provide adequate protection of the TTB’s interests asserted in its Cash
8 Collateral by granting the TTB replacement liens in postpetition assets of the same
9 kind, type, and nature as it holds in Prepetition Collateral (“Postpetition Collateral”),
10 including all proceeds of the Postpetition Collateral (“Replacement Liens”). The
11 Replacement Liens will secure the amount of any diminution in the value of the TTB’s
12 interests in Prepetition Collateral as a result of King Mountain’s use of Cash Collateral.

13 King Mountain’s Budget contains the projected cash expenses for the period of
14 interim Cash Collateral use and beyond. *Thompson Decl.*, ¶ 15. The Budget tracks
15 King Mountain’s working capital collateral (Cash + A/R + Inventory) (“Working
16 Capital Collateral”). *Id.* The Working Capital Collateral secures the TTB’s Federal
17 Tax Lien. *Id.* Specifically, the Budget shows that total Working Capital Collateral will
18 remain stable or increase. *Id.*

19 The Replacement Liens would be in addition to the Prepetition Liens, and would
20 remain in full force and effect notwithstanding any subsequent conversion or dismissal
21 of this case. *Thompson Decl.*, ¶ 16. The Replacement Liens would be valid, perfected
22 and enforceable security interests and liens on the Debtor’s Postpetition Collateral
23 without further filing or recording of any document or instrument or any other action,

1 but only to the extent of Cash Collateral used during the term of the Interim Order and
2 any diminution in value of the Prepetition Collateral, and only to the extent of the
3 enforceability of the TTB's security interests in the Prepetition Collateral. *Id.* Thus,
4 the TTB is adequately protected as to its Federal Tax Lien when the Replacement Liens
5 are taken into account.

6 2. Insurance

7 The Debtor will continue to maintain insurance on its assets, the same existing as
8 of the Petition Date. *Thompson Decl.*, ¶ 17.

9 3. Superpriority Administrative Expense Claim

10 Under § 507(b) of the Bankruptcy Code, all obligations subject to the
11 Replacement Liens have priority in payment over all other administrative expenses of
12 the estate other than the Professional Fund (as defined herein), to the extent that the
13 Replacement Liens are insufficient to compensate the TTB for any diminution in the
14 value of its interests as a result of the Debtor's use of Cash Collateral.

15 **D. Professional Fund**

16 The Replacement Liens shall be subject only to a carveout for the payment of the
17 allowed fees and costs of all professionals retained in this chapter 11 case, and to
18 quarterly fees under 28 U.S.C. § 1930 (the "Carveout"). *Thompson Decl.*, ¶ 18. The
19 Budget contains a line item for the accrual of funds to be deposited into an interest
20 bearing trust account maintained by Bush Kornfeld LLP, King Mountain's general
21 bankruptcy counsel ("Professional Fund") for the payment of these expenses. The
22 purpose of the Professional Fund is to assure that all estate professionals are treated
23 identically and that funds are available to pay administrative expenses incurred during

1 the case, as allowed by order of this court or (in the case of U.S. Trustee fees) by
2 statute. The Carveout shall apply to all amounts in the Professional Fund as well as
3 funds in any prepetition retainers paid by King Mountain to its professionals. *Id.* To
4 the extent the amounts deposited into the Professional Fund exceed the allowed fees
5 and costs of the respective estate and Committee professionals, such excess funds shall
6 remain subject to the rights of the TTB. *Id.*

7 III. LEGAL AUTHORITY

8 A. Use of Cash Collateral

9 Section 363(c) of the Bankruptcy Code provides that:

10 (2) The Trustee may not use, sell or lease cash collateral under paragraph (1)
11 of this subsection unless

12 (A) each entity that has an interest in such cash collateral consents; or

13 (B) the court, after notice and a hearing, authorizes such use, sale, or
14 lease in accordance with the provisions of this section.

15 Section 363(a) defines “cash collateral” to include “cash, negotiable instruments,
16 documents of title, securities, deposit accounts, or other cash equivalents whenever
17 acquired in which the estate and an entity other than the estate have an interest and
18 includes the proceeds, products, offspring, rents, or profits of property and the fees,
19 charges, accounts or other payments, whether existing before or after the
20 commencement of a case under this title.” 11 U.S.C. § 363(a).

21 King Mountain represents that it has insufficient funds to operate unless it uses
22 Cash Collateral, as it holds no unencumbered funds and does not have sources of
23 unencumbered funds, and that the present circumstances require King Mountain to use
Cash Collateral in order to maintain its ongoing business for the benefit of its estate and

1 creditors. *Thompson Decl.*, ¶ 19. The use of Cash Collateral will allow King Mountain
2 to continue to operate and to preserve all of the assets of the business, thereby allowing
3 creditors the best opportunity to recover on their claims. *Id.* King Mountain also has
4 an immediate need to use Cash Collateral to maintain, preserve and protect its assets
5 and has provided for adequate protection of the TTB's interests in the Cash Collateral,
6 as described above and discussed below. *Id.* For these reasons, King Mountain
7 respectfully requests the court authorize the use of Cash Collateral pursuant to the
8 terms of the proposed Interim Order filed herewith.

9 The authority of the Debtor to use Cash Collateral would terminate
10 automatically upon the earlier of (each, a "Change Event") (a) the Debtor's material
11 breach of the Interim Order; (b) entry of an order that stays, reverses, vacates, or
12 modifies the Interim Order in any material respect without the TTB's prior written
13 consent, unless such order otherwise provides; (c) conversion of the Debtor's case to a
14 case under chapter 7 of the Bankruptcy Code; or (d) the appointment of a trustee in this
15 chapter 11 case. Upon the occurrence of a Change Event, the TTB would have the
16 right, but not the obligation, to note a hearing before this court seeking such relief as it
17 may deem appropriate upon seven (7) business days' notice to (i) counsel for the
18 Debtor; (ii) counsel for the Committee or, if no such committee has been appointed,
19 then to the twenty largest unsecured creditors; (iii) the Office of the U.S. Trustee; and
20 (iv) all parties that have requested special notice herein.

21 **B. Adequate Protection**

22 In exchange for the use of Cash Collateral, the TTB requires adequate protection
23 from the Debtor. Bankruptcy Code section 363(e) provides in relevant part that "on

1 request of an entity that has an interest in property used, sold, or leased . . . the court . . .
2 shall prohibit or condition such use, sale, or lease as is necessary to provide adequate
3 protection of such interest.” 11 U.S.C. § 363(e). “Adequate protection” is a flexible
4 concept that should be adapted to the circumstances of the case. *See Crocker Nat’l*
5 *Bank v. Am. Mariner Indus., Inc. (In re Am. Mariner Indus., Inc.)*, 734 F.2d 426, 430–
6 32, 435 (9th Cir. 1984) (superseded on unrelated issues in *United Savings Assn. v.*
7 *Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 108 S.Ct. 626 (1988)). Equitable
8 considerations play a significant role in this analysis. *See, e.g., Albion Prod. Credit*
9 *Assoc. v. Langley (In re Langley)*, 30 B.R. 595, 605 (Bankr. N.D. Ind. 1983).

10 The purpose of adequate protection under Bankruptcy Code § 363 is to
11 compensate a secured party solely for the diminution in value of its collateral. *Qmect,*
12 *Inc. v. Burlingame Capital Partners II, L.P.*, 373 B.R. 682, 689-90 (N.D. Cal. 2007)
13 citing *In re Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 377, 108 S.Ct. 626
14 (1988)). Adequate protection payments are not to be used to compensate the creditor
15 for lost interest or to provide lost opportunity costs. *In re Weinstein*, 227 B.R. 284, 296
16 (9th Cir. BAP 1998) (citing *Timbers*, 484 U.S. 365). Adequate protection is not meant
17 to be a guarantee that a creditor will be paid in full. Instead, the court must determine
18 whether the creditor’s interests are protected as nearly as possible against the possible
19 risks to that interest. *In re Ernst Home Ctr.*, 209 B.R. 955, 966 (Bankr. W.D. Wash.
20 1997); *In re McCombs Properties VI, Ltd.*, 88 B.R. 261, 267 (Bankr. C.D. Cal. 1988)).

21 To assure that the TTB’s interests are adequately protected and to assure no
22 diminution in value of its collateral, the Debtor has proposed to grant the TTB
23 Replacement Liens in Postpetition Collateral of the same type in which its prepetition

1 lien attached to the Prepetition Collateral, in the same priority and validity as its
2 prepetition liens, as necessary to secure the diminution in the TTB's interests, if any, as
3 a result of King Mountain's use of Cash Collateral. *Thompson Decl.*, ¶ 20. To the
4 extent of any diminution in value ultimately due to Cash Collateral use not otherwise
5 protected by the Replacement Liens granted herein, the TTB shall retain its rights under
6 section 507(b) of the Bankruptcy Code. *Id.*

7 The Debtor will also provide for regularly monthly reporting and maintenance of
8 insurance on the Prepetition Collateral. *Thompson Decl.*, ¶ 21. In this regard, the
9 Budget currently projects no deterioration in King Mountain's Working Capital
10 Collateral during the interim period. *Id.* The Budget projects continued, normalized
11 sales projections and payments. *Id.* Thus, the Replacement Liens provide adequate
12 protection of the TTB's interests in the Prepetition Collateral. *Id.*

13 III. CONCLUSION

14 The Debtor has an immediate need to use Cash Collateral to maintain, preserve
15 and protect its assets and have legally provided for adequate protection of the TTB's
16 interests in the Cash Collateral. For these reasons, the Debtor respectfully requests the
17 court authorize the use of Cash Collateral pursuant to the terms of the proposed Interim
18 Order filed herewith, and set a final hearing on these matters.

19 DATED this 29th day of October, 2020.

20 BUSH KORNFIELD LLP

21 By /s/ James L. Day
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23 Richard B. Keeton, WSBA #51537
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